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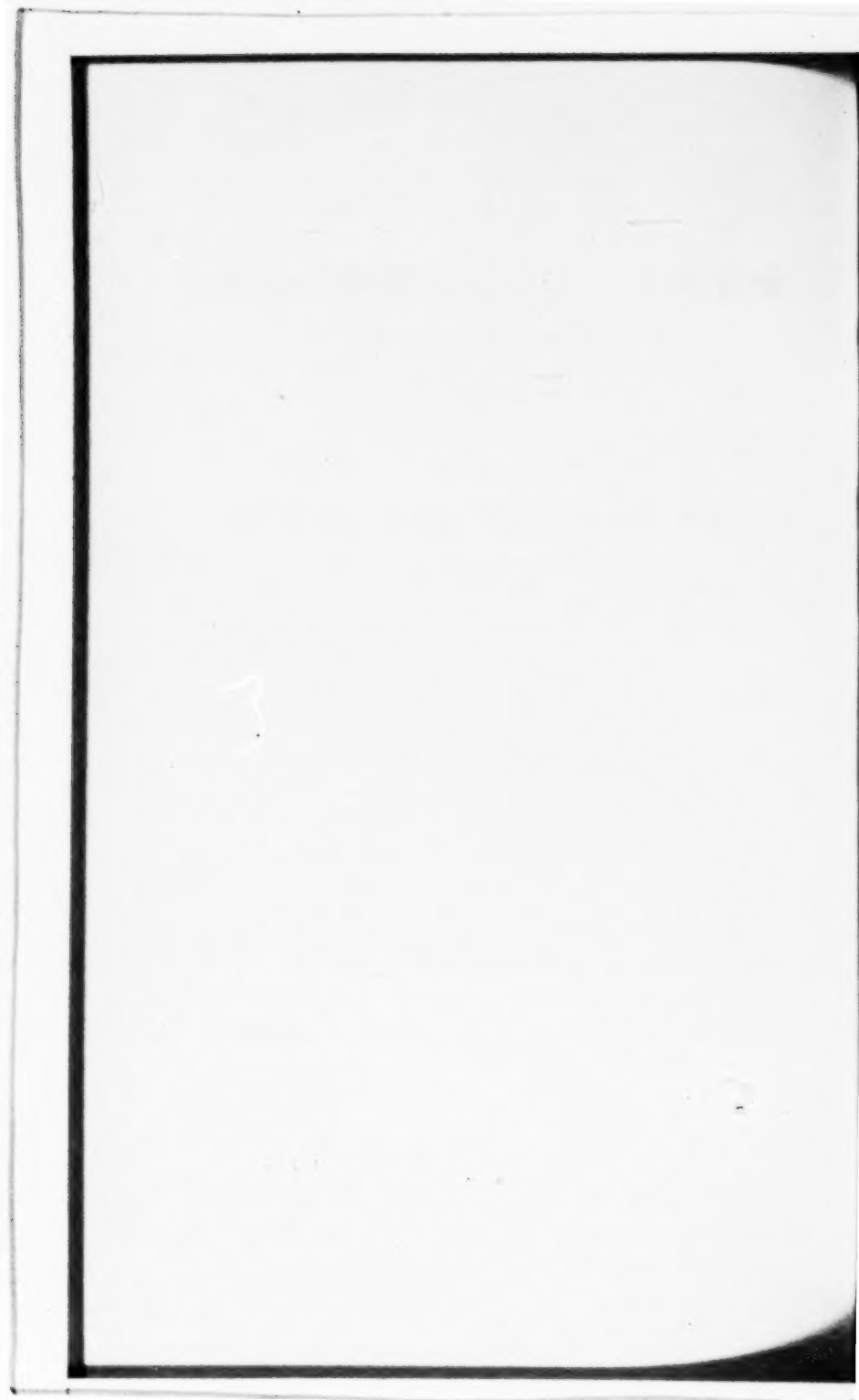
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1947

No. 770

PORTER ROYALTY POOL, INC., A CORPORATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States
Circuit Court of Appeals for the Sixth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 191-217) is reported at 7 T. C. 685. The opinion of the Circuit Court of Appeals (R. 224-228) is reported at 165 F. 2d 933.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 3, 1948 (R. 223). The

petition for a writ of certiorari was filed on April 28, 1948. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the courts below correctly held that the taxpayer, regularly organized as a corporation and adjudicated by a state court to be the owner of certain oil royalty interests and entitled to the income derived from such interests, is taxable on the royalty income in question and is not simply an agent for its receipt.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 13 (As amended by Sec. 101, Second Revenue Act of 1940, c. 757, 54 Stat. 974). TAX ON CORPORATIONS IN GENERAL.

* * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than \$25,000 * * *

* * * *

(26 U. S. C. 1940 ed., Sec. 13.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for per-

sonal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U. S. C. 1940 ed., Sec. 22.)

STATEMENT

The taxpayer was organized as a corporation to effectuate a partial pooling of royalty interests of certain landowners who had leased their land for the drilling of oil and gas wells. At various dates prior to December 1, 1933, each of the lessors had entered into an agreement with certain promoters and trustees whereby the lessors assigned to the trustees one-half of their retained royalty interests in the oil and gas to be produced, it being agreed that the taxpayer corporation would be organized if commercially producing wells were brought in on any of the lands and that the trustees would transfer the royalty interests to the corporation, the lessors receiving shares of stock in the corporation. It was also agreed that twenty-five percent of the stock would be issued to the promoters in consideration of their services (R. 193-198). The taxpayer was duly incorporated in Michigan on

May 22, 1933 (R. 198). On June 16, 1933, the trustees transferred to the corporation the royalty interests which they had held in trust and, thereafter, the taxpayer issued its shares of stock to the persons entitled to them (R. 201). The stock certificates, as provided for in the taxpayer's by-laws, recited that they were issued in consideration for the royalty interests that were transferred, and that the assignors had agreed that good and merchantable title to the royalties had been conveyed (R. 199). The certificates further recited that if the title conveyed was not good or if liens were allowed to impair the corporation's title, the taxpayer possessed the right to apply dividends to perfect its title (R. 200). The taxpayer's by-laws also provided that, except for litigation or legal fees, its expenses for management and operation should not exceed \$1,500 per year; its profits, except for the maintenance of a minimum cash balance of \$200, were to be distributed by way of monthly dividends to its stockholders (R. 200-201).

Subsequently, certain of the fee owners refused to accept their stock and instituted litigation seeking a rescission of the pooling agreement on the ground that there had been fraud and misrepresentations in the organization of the pool, and a violation of the Michigan Blue Sky Laws in the organization of the taxpayer corporation (R. 201-202). This litigation was ultimately resolved in favor of the taxpayer corporation by the Supreme

Court of Michigan, which decreed that the taxpayer was the owner of the royalty interests transferred to it and that the landowner lessors were not. It was also ruled that the royalty income which had been impounded during the suit should be paid to the taxpayer (R. 202-206). The taxpayer expended \$132,000 out of its income during the taxable years in question in conducting this litigation (R. 206-208).

The Tax Court determined deficiencies in income tax for the taxable years 1940 and 1941 (R. 217), which resulted from its holding that the taxpayer corporation was the taxable owner of the oil royalties which it received in those years. The Circuit Court of Appeals affirmed the decision of the Tax Court in all respects (R. 224-228).

ARGUMENT

1. The petition for a writ of certiorari seeks review of only one aspect of the decision below, namely, the holding (R. 227) that the taxpayer was the taxable owner of the oil royalties which it collected, and that it was not acting as a "conduit" or as an "agent" for someone else. The decision of the court below is altogether correct. To the extent that the taxpayer seems to argue that the facts of this case establish that it was acting as an agent for its stockholders (Pet. 15-18), or for the members of the original pooling agreement (Pet. 14-15), the Tax Court (R. 215) found the facts to

the contrary, and the Circuit Court of Appeals (R. 227) upheld the Tax Court saying that "this contention is without merit" and that it finds "no support in the agreements between the parties."

That the record supports, indeed, compels, the conclusion of the courts below is evidenced from the fact that the Supreme Court of Michigan had adjudicated that the taxpayer (R. 107) was the sole owner of the oil royalties and of the proceeds from the sale of the royalty oil and also (R. 108) that the taxpayer's stockholders had no right, title, or interest in the oil royalties or in the royalty income "save only in their capacity as stockholders * * * in accordance with the laws relating to corporations, all pursuant to the terms of the royalty pool agreement." As a result, the stockholders here had no interest in the taxpayer's income which would be different from that of a stockholder in the income of any other corporation. They, as all other stockholders, are only entitled to share in the corporation's profits by way of dividend distributions. These circumstances make applicable the decisions of this Court to the effect that the corporation is the entity which Congress has selected to be taxed on its income. *Moline Properties v. Commissioner*, 319 U. S. 436; *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44; *Burnet v. Commonwealth Imp. Co.*, 287 U. S. 415. The stockholders, in addition, will be taxable on such income as they may derive from dividend distributions.

The taxpayer points to nothing in the evidence which would have compelled the Tax Court to conclude that an agency or any other relationship existed between it and its stockholders, or between it and the pool members, and that they, rather than the taxpayer, are the taxable owners of the income in question. It should be parenthetically observed that the stockholders and the pool members are not identical groups of individuals. Since the taxpayer undeniably possessed full ownership under state law of the income producing property and of the income derived therefrom, it is difficult to comprehend how it possibly could have acted as an agent or in a fiduciary capacity with regard to property which it owned in all respects.

2. There is no conflict in decisions. *Moline Properties v. Commissioner*, *supra* (Pet. 18), holding that the corporation, and not its sole stockholder, is taxable on gains derived from property belonging to the corporation, is fully in accord with the decision below. *Commissioner v. Turney*, 82 F. 2d 661 (C. C. A. 5th), in which the taxpayer was not entitled to the income in question and which did not involve the relationship between a corporation and its stockholders, is clearly not in point. *112 West 59th St. Corp. v. Helvering*, 68 F. 2d 397 (App. D. C.), in which the beneficial ownership of the property was held not to be in the corporation, is not only distinguishable on its facts, but it is of doubtful authority since it was one of the cases

giving rise to the conflict in decisions on the basis of which certiorari was granted in the *Moline Properties* case, *supra*. See 319 U. S. 436, 437, fn. 1.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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May, 1948.